

Tax Risk Management

From risk to opportunity

Edited by
Anuschka Bakker and Sander Kloosterhof



Table of Contents

Foreword	v
Acknowledgements	ix
Chapter 1: Introduction to Tax Risk Management	
1. Introduction	1
2. Valuation of the tax position	2
3. Economic capital	7
4. Reporting of tax risks – Tax risk management from an accounting perspective	10
5. Reputational risk	13
6. Operational tax risk	15
7. Tactical tax risk management	16
8. Integrated tax risk management	17
Chapter 2: Tax Control Framework	
1. From risk management to opportunity management	19
2. Tax control framework	20
2.1. Terms and definitions	20
2.2. Building an effective, efficient and transparent tax function	21
2.3. From risk to opportunity	23
2.4. What is tax control?	24
2.5. Overview of the building blocks	25
2.6. Overview of the roles	25
2.7. Stakeholders	27
3. Building the tax control framework	30
3.1. Introduction	30
3.2. Tax strategy	31
3.3. Tax operations and risk	38
3.4. Tax accounting and reporting	51
3.5. Tax compliance: a global scope	56
3.6. Automation	57
3.7. Organization and resources	61
4. Culture	63

Table of Contents

4.1.	How can sustainable compliance be achieved without losing flexibility and creativity?	64
4.2.	Alternatives to COSO	65
4.3.	Levers of control	66
5.	How to get started	67
5.1.	Blueprint TCF	68
5.2.	Conclusion	70

Chapter 3: Tax Accounting

1.	Introduction	73
2.	Part I – Risk of incorrect reporting of income taxes in the financial statements	75
2.1.	Overview	75
2.2.	Complexity and pervasiveness equals risk	76
2.2.1.	IAS 12 and ASC 740 overview	76
2.2.1.1.	Recognition of deferred tax assets	77
2.2.1.2.	Special topics	79
2.2.1.3.	Interim reporting	81
2.3.	Consequences	81
2.4.	Today's tax department	82
2.4.1.	European headquarters – Scenario 1	83
2.4.2.	HQ income tax calculation and consolidation	85
2.4.3.	US subsidiary – Scenario 2	86
2.5.	Risk mitigation	88
2.5.1.	Internal controls	89
2.5.2.	Standardization	89
2.5.3.	Personnel training	90
2.5.4.	Technology	90
2.5.5.	Interim period and year-end strategies (e.g. preliminary hard-close process)	91
2.5.6.	Outside resources	92
2.6.	On the horizon	92
3.	Part II – Accounting for income tax risks in the financial statements	94
3.1.	Overview	94
3.2.	A brief history	95
3.3.	Accounting for uncertain tax positions under US GAAP and IFRS – An overview	97

3.3.1.	Accounting for uncertain tax positions under ASC 740	97
3.3.2.	IAS 12 versus ASC 740 – Overview and key differences	103
3.3.3.	What does this mean?	105
3.4.	Accounting for non-income-based tax risks	107
4.	Conclusion	110

Chapter 4: Tax Risk Management and Corporate Taxpayers – International Tax Administration Developments

1.	Tax risk management: the different perspectives of tax authorities and corporate taxpayers	111
2.	Economic and social developments	113
3.	Background to tax-related risk management and approaches to regulation	114
3.1.	The growth of risk management	114
3.2.	Corporate governance	115
3.3.	Responsive regulation and enhanced cooperation – A compliance model	116
3.4.	Risk rating	117
3.5.	Limitations of the risk rating approach	118
4.	The OECD initiatives	119
4.1.	The Seoul Declaration and the study into the role of tax intermediaries	119
4.2.	Aggressive tax planning	119
4.3.	Tax risk management and risk rating	120
4.4.	Corporate governance	122
4.5.	International experience of the risk management approach	125
4.6.	Tax compliance and banks	126
4.7.	Difficulties with tax risk management by tax authorities	128
5.	The European Union	130
5.1.	The Fiscalis Guide	130
5.2.	Tax risks arising for tax administrations and corporate taxpayers in the Member States.	130
6.	Conclusion	132

Chapter 5: Australia

1.	Introduction	135
----	--------------	-----

Table of Contents

2.	Tax control framework	137
3.	Impact on tax risk management of legislative and/or regulatory changes and public opinion	138
3.1.	Legislative and regulatory rules	138
3.2.	ATO's compliance model	140
3.3.	Tax legislation	143
3.3.1.	Anti-avoidance mechanisms and associated risks	143
3.3.2.	Transfer pricing rules and-associated risks	144
3.3.3.	Dividend imputation	144
3.4.	Commercial environment	145
4.	Tax control framework in practice	147
4.1.	Common mechanisms of tax control frameworks	148
4.2.	Benefits of sound tax control frameworks	150
5.	Approach of tax authorities	151
5.1.	Risk reviews and audits	152
5.2.	Legal professional privilege and accountants' concession	154
6.	Tax risk management in a global environment	155
6.1.	International arrangements entered into by Australian taxpayers	155
6.2.	Australian bilateral agreements on tax issues	157
6.3.	Implications for businesses operating internationally	157
7.	Future developments and expected implications related to changed approach to tax risk management	158
7.1.	Henry tax system review	159
7.2.	Tax reporting	159

Chapter 6: Canada

1.	Introduction	161
2.	Short description of the tax control framework	163
2.1.	Nature and scope of a tax control framework	163
2.2.	Corporate governance and internal controls	164
2.3.	Stakeholders of a tax control framework	165
2.4.	The role of technology in a tax control framework	166
2.5.	Efficiently organizing the tax function as part of the tax control framework	167
3.	Impact of legislative and/or regulatory changes and public opinion	167
3.1.	Accounting standards	167
3.1.1.	Public companies	168

3.1.2.	Private companies	169
3.2.	Responsibilities under various taxation acts	169
4.	Tax control framework in practice	171
4.1.	Objectives and benefits of a tax control framework	171
4.2.	Nature and classification of tax risks	172
4.3.	Managing tax risks in practice	175
4.4.	Industry differences	177
5.	Approach of the tax authorities	177
5.1.	Audits	177
5.2.	Record keeping	179
5.3.	Demand for information	179
5.4.	“Client-attorney privilege”	180
5.5.	Tools for taxpayer	181
5.5.1.	Voluntary Disclosures Program (VDP)	181
5.5.2.	Income tax rulings and interpretations	181
5.5.2.1.	Advance income tax rulings	181
5.5.2.2.	Technical interpretations	182
6.	Tax risk management in a global environment	182
7.	Future developments and expected implications related to changed approach to tax risk management	185
7.1.	International Financial Reporting Standards	185
7.2.	Tax harmonization versus globalization	186
7.3.	Importance of information technologies department and knowledge	186
7.4.	Implications for third parties	187

Chapter 7: China

1.	Introduction	189
2.	Short description of tax control framework	191
2.1.	Registration requirements	191
2.2.	Accounting records and books	192
3.	Impact of legislative/regulatory changes and public opinion	192
3.1.	Tax risk management for large enterprises	192
3.2.	Basic standard for enterprise internal control	193
3.3.	Disclosure requirements for listed companies	194
4.	Tax control framework in practice	195
4.1.	Multinationals versus domestic companies	196
4.2.	Tax risk management guidelines	196
4.2.1.	Tax payment	198
4.2.2.	Withholding tax	198
4.2.3.	Penalties	198

Table of Contents

4.2.4.	Due process	199
4.2.5.	Statute of limitations	199
4.2.6.	Anti-avoidance	200
4.2.7.	Liability of shareholders, directors and officers	201
4.3.	Specific tax risks	201
4.4.	Development of a tax risk management framework	202
4.5.	Nature and classification of tax risks	203
4.5.1.	Enterprise income tax	204
4.5.2.	Value added tax (VAT)	205
4.5.3.	Business tax (BT)	206
4.5.4.	Consumption tax	207
4.5.5.	Real estate tax	207
4.5.6.	Land value added tax (“land VAT”)	208
4.5.7.	Deed tax	208
4.5.8.	Resource tax	209
4.5.9.	Stamp duty	209
4.5.10.	Customs duties	209
4.6.	Recent legislative and regulatory changes	209
4.6.1.	The Tax Administration Department for Large Enterprises	210
4.6.2.	Transfer pricing	212
4.6.3.	Thin capitalization	215
4.6.4.	General anti-avoidance rules	216
4.6.5.	Industry-based tax incentives	217
5.	Approach of the tax authorities	217
5.1.	Deciphering tax laws and regulations	217
5.2.	Negotiating with tax authorities	218
5.3.	Challenging tax laws and regulations	219
5.4.	Coordination between government agencies	219
6.	Tax risk management in the global environment	220
6.1.	<i>Xinjiang</i> case	221
6.2.	<i>Chongqing</i> case	222
6.3.	Additional anti-avoidance measures	223
7.	Future developments	224
 Chapter 8: France		
1.	Introduction	227
2.	Short description of the tax control framework	229
3.	Impact of legislative and/or regulatory changes and public opinion	230

4.	Tax control framework in practice	233
4.1.	Objectives of tax risk management as viewed by French businesses	233
4.1.1.	Objectives of tax risk management from a French point of view	234
4.1.2.	Is tax risk strategic or operational?	236
4.2.	General tax risk framework	236
4.2.1.	Compliance	237
4.2.1.1.	Corporate income tax	237
4.2.1.2.	VAT	238
4.2.1.3.	Customs duties	239
4.2.1.4.	Business tax	240
4.2.1.5.	Other taxes	240
4.2.1.6.	Archiving requirements	241
4.2.2.	Operations	241
4.2.2.1.	Validation of the accounting income from a tax point of view	241
4.2.2.2.	Book-to-tax adjustments	242
4.2.3.	Restructuring	243
4.2.4.	Cross-border operations and intragroup transactions	244
4.2.4.1.	Intragroup cross-border transactions	245
4.2.4.2.	Anti-avoidance rules	245
4.2.5.	Tax planning	246
4.2.6.	Industrial approach	247
4.3.	The perceived benefit of a sound tax control framework	248
5.	Approach of the tax authorities	249
6.	Tax risk management in a global environment	250
6.1.	Improved cooperation with foreign authorities	251
6.2.	Reporting on tax risks under the FIN 48 provisions	252
7.	Future development and expected implications related to changed approach to tax risk management	252

Chapter 9: Germany

1.	Introduction	255
2.	Tax control framework	257
3.	Impact of legislative changes and lessons learned	259
3.1.	German Corporate Governance Codex	259
3.2.	BilMoG – Amended corporate governance rules	260

Table of Contents

3.3.	SOX 404 and lessons learned	261
4.	Tax control framework in practice	262
4.1.	Tax risk management as an audit issue	262
4.2.	Set-up of a tax risk management system	263
5.	Approach of the tax authorities	265
5.1.	Tax system and record retention regulations	265
5.2.	Tax audit regulations	266
5.3.	Penalties and other sanctions	269
5.4.	Specific tax rules creating risk	275
5.5.	Tax rulings	279
6.	Tax risk management in a global environment	281
7.	Future developments	281

Chapter 10: Japan

1.	Introduction	289
2.	Short description of tax control framework	291
2.1.	Introduction	291
2.2.	Tax system	292
3.	Impact of legislative and/or regulatory changes and public opinion	296
4.	Tax control framework in practice	298
4.1.	Introduction	298
4.2.	Specific risks	299
4.2.1.	Mitigation of domestic risk	302
4.2.2.	International mitigation	304
5.	Approach of the tax authorities	305
6.	Recent developments	306

Chapter 11: Mexico

1.	Introduction	309
2.	Short description of the tax control framework	310
3.	Impact of legislative and/or regulatory changes and public opinion	315
4.	Tax control framework in practice	317
5.	Approach of the tax authorities	323
6.	Tax risk management in a global environment	324
7.	Future developments and expected implications related to changed approach to tax risk management	325

Chapter 12: Netherlands

1.	Introduction	327
2.	Common tax risks in the Netherlands	329
3.	The interdependence of reputational, legislative and tax supervision risks: the impact of legislative and/or regulatory changes and public opinion	331
4.	Approach of the Dutch tax authorities; compliance agreement	333
5.	Horizontal monitoring is the key driver for the enhanced focus on tax control framework in the Netherlands	335
6.	Tax risk management in a global environment	346
7.	Future developments and expected implications related to changed approach to tax risk management	350

Chapter 13: Singapore

1.	Introduction	353
	1.1. Perception of taxes	353
	1.2. Perception of tax collection agency	354
2.	Description of the tax risk management framework	356
	2.1. Small and medium-sized enterprises (SMEs)	356
	2.2. Multinationals (MNCs)	357
3.	Impact of legislative and/or regulatory changes and public opinion	357
	3.1. Impact of global regulatory changes	357
	3.2. Should Singapore companies follow SOX as a tax risk management tool?	359
	3.3. IRAS' responses to global trends	360
	3.4. Relationship between IRAS and taxpayers	361
4.	Tax control framework in practice	361
	4.1. Objectives of a tax control framework	361
	4.2. Tax risks – Explanation, identification and management	362
	4.3. Common mechanisms for managing tax risks	372
	4.4. Benefits of a tax control framework	375
5.	Approach of the tax authorities	375
	5.1. Advance tax ruling	375
	5.2. Voluntary Disclosure Program (VDP)	376
	5.3. Legal professional privilege	377
6.	Tax risk management in a global environment	378
	6.1. Cross-border transactions by taxpayers	379
	6.2. Cooperation with foreign tax authorities	379

Table of Contents

7.	Future developments and expected implications related to changed approach to tax risk management	380
7.1.	Impact on taxpayers	380
7.2.	Impact on tax advisors	380
7.3.	Impact on in-house tax advisors	381
7.4.	Impact on IRAS	381

Chapter 14: South Africa

1.	Introduction	383
2.	Description of the tax control framework	385
3.	Impact of legislative and/or regulatory changes and public domain	391
4.	Tax control framework in practice	394
5.	Approach of the tax authorities	400
6.	Tax risk management in a global environment	401
7.	Future developments and expected implications related to changed approach to tax risk management	402

Chapter 15: United Kingdom

1.	Introduction	405
2.	Historic tax authority approach	406
2.1.	Tax returns and enquiries	406
2.2.	Privilege	407
2.3.	Reporting of innovative transactions and associated penalties	408
3.	Developments in the legal and regulatory environment	409
3.1.	Varney review and the risk-based approach	409
3.2.	The new company penalty regime	411
3.3.	Other changes in HMRC powers and behaviours	414
3.4.	Senior accounting officer	415
3.5.	The Code of Practice on Taxation for Banks	418
4.	Other environmental changes	420
4.1.	Analysts and investors	420
4.2.	Other influences	421
5.	Tax control framework in practice	422
5.1.	Management of risk in the United Kingdom	422
5.2.	Key tax risks	423
5.3.	Taking on new risks	424
5.4.	Transforming controls	425
5.5.	Strengthening governance	426

6.	Tax risk management in a global environment	427
7.	Future developments and expected implications	428
8.	Conclusion	429

Chapter 16: United States

1.	Introduction	431
2.	Tax control framework in the United States	432
3.	Impact of legislative and regulatory changes	433
4.	Tax control framework in practice	437
4.1.	Introduction	437
4.1.1.	Data and information	437
4.1.2.	Tax technology and systems	438
4.1.3.	Tax process and policy	438
4.1.4.	People and organization	439
4.2.	Strategic tax risk	440
4.3.	Pertinent tax risks encountered in the United States	445
4.3.1.	Corporate income tax	445
4.3.2.	Accounting for income taxes	447
4.3.2.1.	ASC 740, income taxes	447
4.3.2.2.	ASC 740-10, accounting for uncertainty in income taxes	448
4.3.3.	US state income, franchise and gross receipts taxes	448
4.3.3.1.	US state income tax	449
4.3.3.2.	US state franchise tax	450
4.3.3.3.	US state gross receipts tax	450
4.3.3.4.	US state tax planning	450
4.3.4.	Indirect tax	451
4.3.5.	Payroll-related tax	452
4.3.5.1.	Federal Insurance Contributions Act	452
4.3.5.2.	Federal Unemployment Tax Act	453
4.3.5.3.	Federal income tax withholding	453
4.3.5.4.	State income tax withholding	454
4.3.5.5.	State unemployment insurance tax	454
4.3.6.	Property tax	454
4.3.7.	Additional areas of tax risk to consider	455
4.3.7.1.	Tax operating losses	455
4.3.7.2.	Supply-chain and tax risk	455

Table of Contents

	4.3.7.3.	Transactional risk	455
	4.3.7.4.	Reputational risk	456
5.		Approach by the tax authorities	456
	5.1.	Transactions	457
	5.2.	Reportable transactions	457
	5.3.	Statute of limitations	458
	5.4.	Special IRS examination resolution procedures	459
	5.4.1.	Pre-Filing Agreement (PFA)	459
	5.4.2.	Accelerated Issue Resolution (AIR)	459
	5.4.3.	Compliance Assurance Process (CAP)	459
	5.4.4.	Fast Track Settlement (FTS)	460
	5.4.5.	Limited Issue Focused Examination (LIFE)	460
	5.5.	High-risk areas for IRS examinations	461
	5.5.1.	Issue tiering system	461
	5.5.2.	IRS audit guides	462
6.		Tax risk management in a global environment	463
	6.1.	Introduction	463
	6.2.	Dealing with the global complexity of tax	464
	6.2.1.	Understanding global filing requirements	464
	6.2.2.	Understanding processes	465
	6.2.3.	Tracking transactions	465
	6.2.4.	Tracking foreign tax controversy	465
7.		Future developments and expected implications related to changed approach to tax risk management	466
	7.1.	Change in government administrations	466
	7.2.	IFRS	467
	7.3.	Corporate director's role in tax risk management	467

Chapter 17: Tax Risk Management – :Look before You Leap and Be in Control

1.	Introduction	469
2.	Historic background	470
3.	Essentials with respect to TCF	472
4.	Tax accounting	475
5.	International developments	476
6.	Country perspectives	477
7.	Concluding remarks	481